

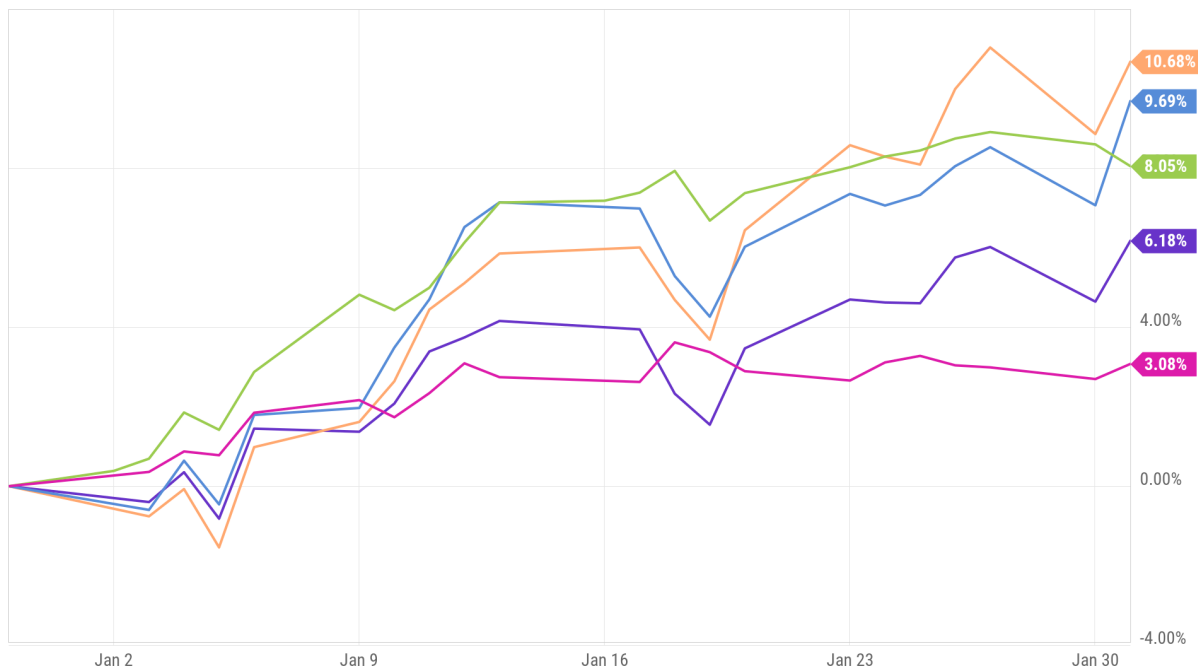
First Five Days

The stock market rally that began on October 13, 2022, continued throughout most of January to mercifully start the year on a positive note. Notably, the first five trading days produced a positive gain of ~1.4% for the S&P 500, which is widely regarded by market participants to be a good indicator that positive results may lay ahead for the full year (often referred to as the “first five days theory”).

Returns were strong for stocks and bonds during the month. The S&P 500 was higher by +6.18%, the NASDAQ Composite jumped +10.68%, the Russell 2000 lifted +9.69% and the MSCI ACWI rose by +8.05% during January. The bond market benefited from declining rates with the 10-year US Treasury rate falling from 3.88% last month to 3.53% at the end of December. This led to an impressive gain of +3.08% for the Bloomberg US Aggregate index. (CHART 1)

Chart 1 - Strong start to 2023

- S&P 500 Level % Change
- Nasdaq Composite Level % Change
- Russell 2000 Level % Change
- MSCI ACWI Ex USA Level % Change
- Bloomberg US Aggregate Level % Change



Source: yCharts and Portfolio Partners



Feb 01 2023, 11:52AM EST. Powered by YCHARTS

CONSUMER PRICE INDEX (CPI)	
DATE	%
January 2021	1.36
February 2021	1.68
March 2021	2.66
April 2021	4.15
May 2021	4.94
June 2021	5.34
July 2021	5.28
August 2021	5.21
September 2021	5.39
October 2021	6.24
November 2021	6.83
December 2021	7.10
January 2022	7.53
February 2022	7.91
March 2022	8.56
April 2022	8.22
May 2022	8.52
June 2022	9.00
July 2022	8.48
August 2022	8.25
September 2022	8.22
October 2022	7.76
November 2022	7.12
December 2022	6.42

CHART 2

PCE ex-FOOD and ENERGY	
DATE	%
January 2021	1.57
February 2021	1.56
March 2021	2.05
April 2021	3.12
May 2021	3.52
June 2021	3.80
July 2021	3.87
August 2021	3.88
September 2021	3.92
October 2021	4.31
November 2021	4.82
December 2021	5.04
January 2022	5.21
February 2022	5.42
March 2022	5.36
April 2022	5.03
May 2022	4.88
June 2022	5.04
July 2022	4.70
August 2022	4.93
September 2022	5.20
October 2022	5.05
November 2022	4.68
December 2022	4.42

CHART 3

Peak Inflation

We believe a key factor driving negative stock and bond returns during 2022 was the Federal Reserve (the Fed) moving from an accommodative policy stance to a non-accommodative policy stance. We called this the “Fed Playbook” and explained that the Fed has a dual mandate to achieve price stability AND maximum sustainable employment. (See our *September 2022 Newsletter* for a tutorial on the Fed’s dual mandate.)

We think the market is starting to perceive that we may have reached peak inflation sometime during the middle of 2022. We like to analyze a combination of the Consumer Price Index (CPI) and Personal Consumption Expenditures excluding food and energy (core PCE) to monitor inflation trends.

The data suggests that CPI may have peaked in June 2022 and core PCE may have peaked in February 2022. Notably, the S&P 500 established a near-term low on October 13, 2022,

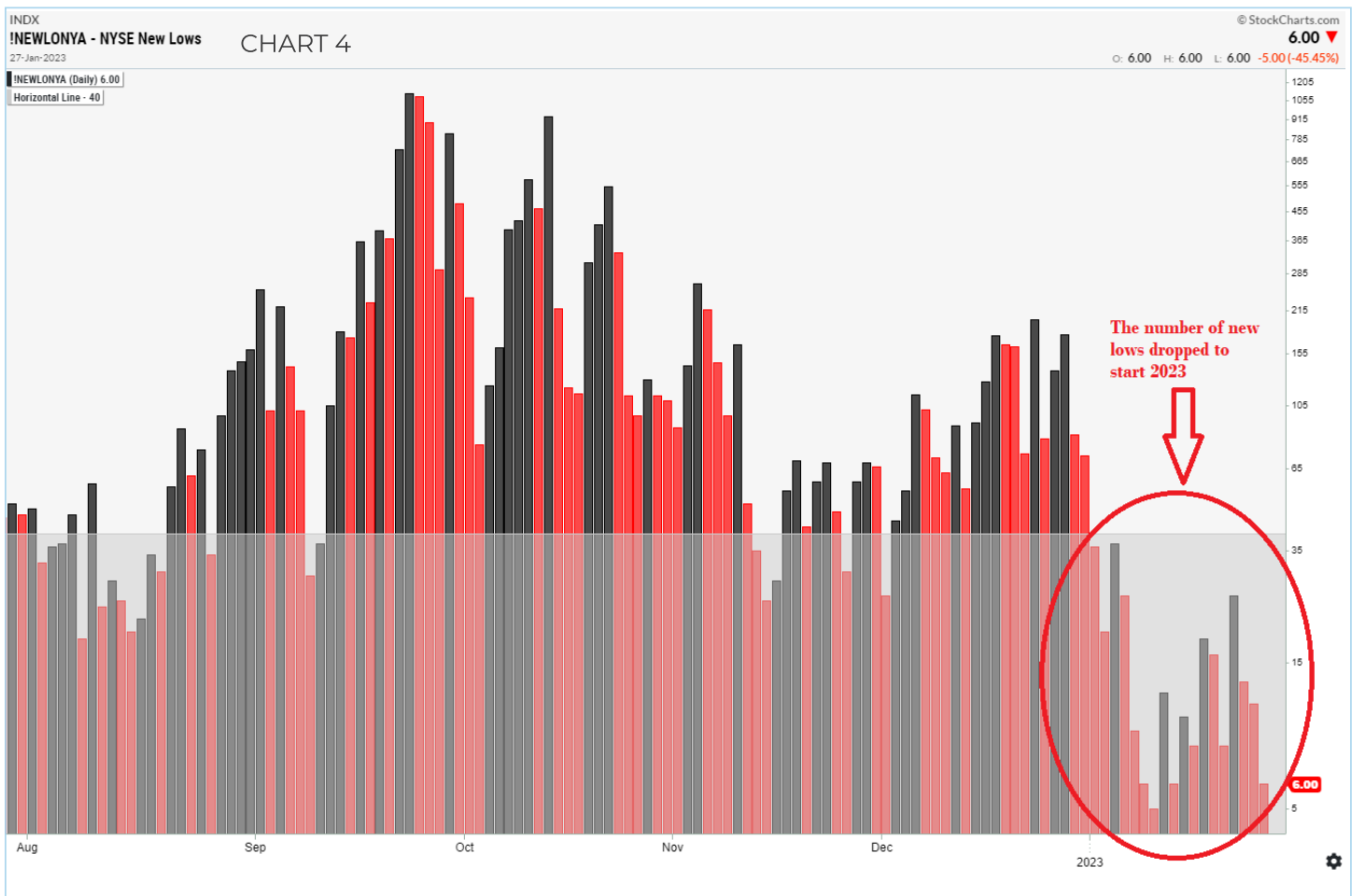
when the September CPI number was released showing a third straight month of declining inflation. We think “Peak Inflation” (or disinflation) may become the dominant theme during 2023. (CHART 2 & 3)

History suggests that the economy (and financial markets) can perform well when prices continue to rise but at a slower pace (disinflation). This is different than deflation, or negative prices, which is what often leads to poor economic outcomes. We are monitoring several economic variables such as money supply, used car prices and home values to gauge the potential trend for inflation. Expect to hear more about these factors throughout 2023.

Open to Possibility

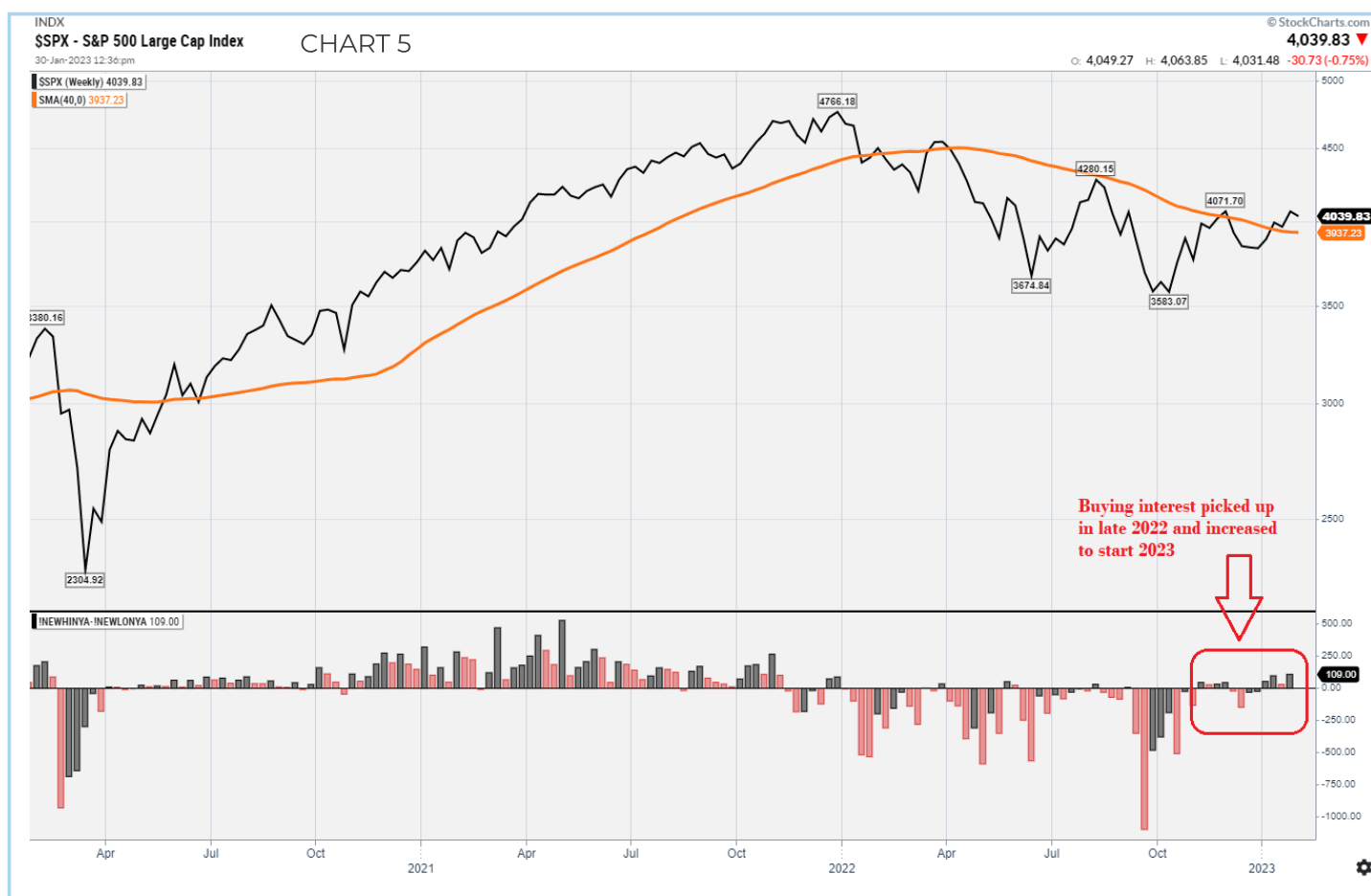
Our message for much of 2022 was to “respect the downtrend.” The simple focus for most of the year was to be positioned relatively defensively as long as the major direction of the stock market was down. We modified this message in the later stages of 2022 to include “but, open to possibility.” The rationale for this change was based on some incremental improvements we were seeing in the underlying action of the stock market as well as some economic data that was “less bad.”

We believe that a market bottom is a process and not a point in time that usually includes at least two steps: sellers must stop selling and buyers must start buying. This may sound overly simplistic, but we use it as a framework to organize information to help frame our market outlook. The number of new lows on the New York Stock Exchange is one of the data points we track to let us know the intensity of the selling pressure in the stock market. We noticed around late November the number of new lows beginning to dissipate and then 2023 started with new lows dropping more meaningfully. (CHART 4)



The number of new highs minus the number of new lows is one of the data points we track to help us identify when the buyers are starting to exert influence over sellers. Again, we noticed around November 2022 that buyers were starting to show up and that trend continued into 2023. These were important clues to support our approach to be “open to possibility.” (CHART 5)

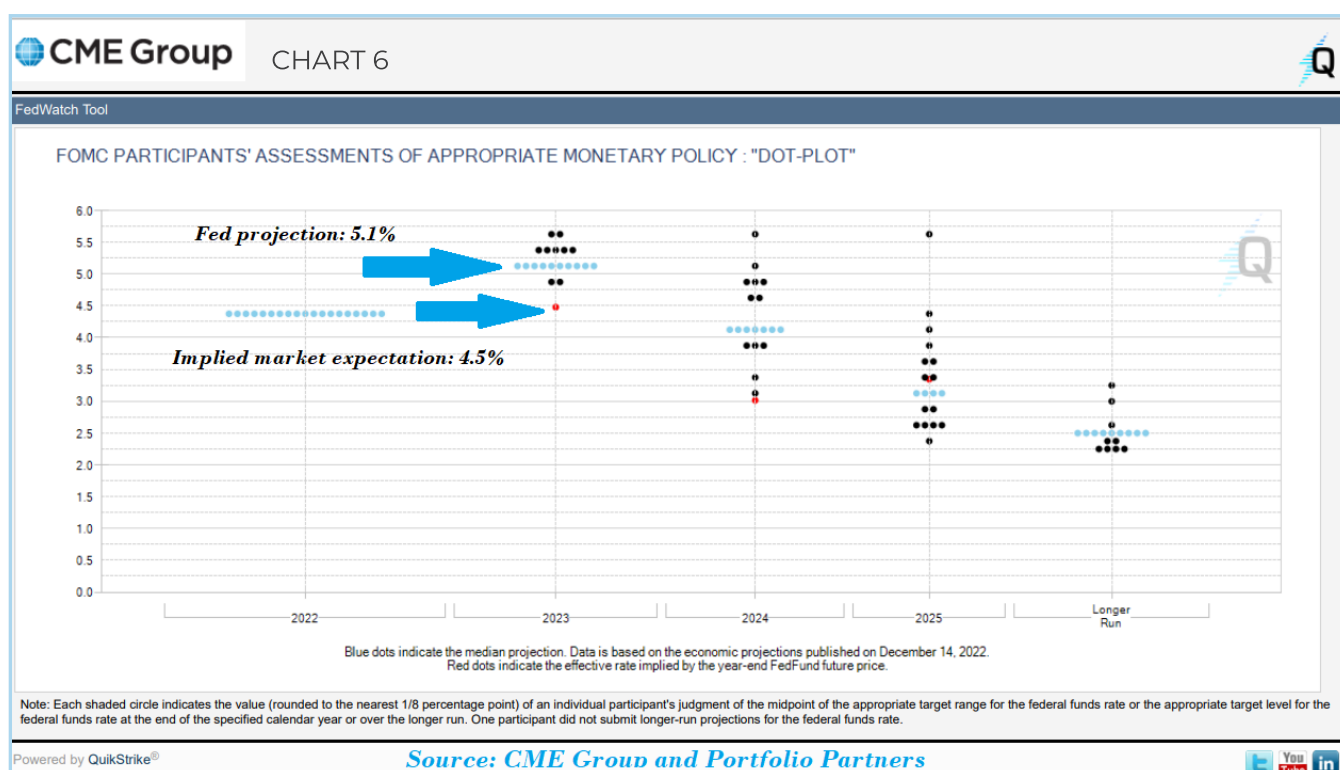
We use our “weight of the evidence” approach to help identify potential inflection points and then have a plan of action ready if the evidence changes. While we have maintained our relatively defensive position throughout 2022, we have a plan to take incremental steps to put more offense in our models if we continue to receive positive information regarding the economy and corporate earnings.



Market Fighting the Fed

We think the biggest hurdle for a prolonged market rally is the disconnect between interest rate guidance provided by the Fed and the market implied expectations for rates. Specifically, the Fed is guiding to an effective Fed Funds rate of 5.1% at the end of 2023, but the market is expecting that rate to only be around 4.5%. In addition, the Fed has consistently stated that they are likely to maintain the Fed funds rate throughout 2023, but the market expectation is for a rate cut in November (according to CME Group). (CHART 6)

As we said, be open to possibility. Although we think the market is currently out of sync with the Fed, we think it has the potential to resolve over the course of the next year or so. Our view is that much of the market action the past year is related to this battle between Fed guidance and market implied expectations. We think this friction is healthy and may create a fertile environment for brighter days ahead.



MARKET TRACKER – 1/31/2023

INDEX	3 mo	1 yr	3 yr	5 yr
S&P 500	5.76%	-8.22%	9.88%	9.54%
MSCI ACWI ex-USA	20.06%	-5.22%	4.12%	1.85%
BLOOMBERG				
US AGGREGATE	6.39%	-8.36%	-2.35%	0.86%

(Source: yCharts and Portfolio Partners)

MARKET TRACKER – 1/31/2023

S&P 500	4,076.60
DIJA.....	34,086.04
NASDAQ	11,584.55
WTI CRUDE OIL.....	\$78.87 /BARREL
GOLD	\$1,929.50 /OUNCE
10-YEAR TREASURY FIELD.....	3.53%
UNEMPLOYMENT	3.50%
GDP.....	2.90%
PPI	6.24% Year-Over-Year
CORE CPE (INFLATION)	4.24% Year-Over-Year

(Source: yCharts, Dorsey Wright and Portfolio Partners)

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The index, a member of the Dow Jones Total Stock Market Indices family, is designed to measure the performance of small-cap U.S. equity securities.

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The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq. The Nasdaq is a global electronic marketplace for buying and selling securities, as well as the benchmark index for U.S. technology stocks and is also used to refer to the Nasdaq Composite, an index of more than 3,000 stocks listed on the Nasdaq exchange.

The NASDAQ Composite Index includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index is a broad based index. The MSCI EAFE index is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted. The Bloomberg Barclays US Aggregate Bond Index, which was originally called the Lehman Aggregate

Bond Index, is a broad based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate debt securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS and CMBS (agency and non-agency) debt securities that are rated at least Baa3 by Moody's and BBB- by S&P. Taxable municipals, including Build America bonds and a small amount of foreign bonds traded in U.S. markets are also included. Eligible bonds must have at least one year until final maturity, but in practice the index holdings has a fluctuating average life of around 8.25 years. This total return index, created in 1986 with history backfilled to January 1, 1976, is unhedged and rebalances monthly.

The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe and is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The MSCI All-Country World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indexes comprising 23 developed and 23 emerging market country indexes. The developed country indexes include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indexes included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.